No. 88-658

Supreme Court, U.S.
FILED
OCT 17 1988
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

PANHANDLE EASTERN PIPE LINE COMPANY,

Petitioner,

v.

STATE OF ILLINOIS, ex rel. NEIL F. HARTIGAN, Attorney General of the State of Illinois,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Of Counsel:

JOHN A. SIEGER
IRWIN A. BAIN
PANHANDLE EASTERN
PIPE LINE COMPANY
5400 Westheimer Court
Houston, Texas 77056
(713) 627-5400

PAUL H. LARUE *
JURIS KINS
GREGORY G. WROBEL
JAMES M. MROWICKI
ANDREW M. GARDNER
CHADWELL & KAYSER, LTD.
8500 Sears Tower
Chicago, Illinois 60606
(312) 876-2100

Attorneys for Petitioner
PANHANDLE EASTERN PIPE
LINE COMPANY

* Counsel of Record

Midwest Law Printing Co., Chicago 60611, (312) 321-0220

QUESTIONS PRESENTED

1. Does the *en banc* decision below in effect overrule this Court's holding in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), barring indirect purchaser antitrust damage suits?

2. Are residential indirect purchasers of natural gas from petitioner, who do not purchase gas pursuant to preexisting, fixed quantity, cost-plus contracts with the direct purchaser, barred from seeking damages under Section 4 of the Clayton Act, 15 U.S.C. § 15 ("Section 4"), by *Illinois Brick*?

TABLE OF CONTENTS

	PAGE
Questions Presented	i
Table of Authorities	iv
Opinions Below	2
Jurisdiction	2
Statute Involved	2
Statement of the Case	3
Reasons for Granting the Writ	7
I. The Seventh Circuit's Decision Is In Direct Conflict With This Court's Controlling Decisions In *Hanover Shoe* And *Illinois Brick*	7
A. The Seventh Circuit's Decision Improperly Reexamines And Substantially Erodes The General Bar Of Indirect Purchaser Claims	8
B. The Seventh Circuit's Decision Expands The Cost-Plus Exception By Eliminating The Preexisting Fixed Quantity Contract Requirement	11
II. The Seventh Circuit's Opinion Adds To A Conflict Among The Circuits On The Limited Circumstances That Permit Suits By Indirect Purchasers For Recovery Of An Illegal Overcharge	14
A. The Circuits Are Split Over The Fixed Quantity Requirement	15

B. The Circuits Are Divided As To The Propriety Of The Functional Equivalent Approach 16

C. The Seventh Circuit's Decision Conflicts With A Ruling Of The Sixth Circuit Regarding The "Preexistence" Requirement 18

D. The Conflict Is Clear From The *En Banc* Decision Itself 18

III. To Preserve The *Illinois Brick* Rule And To Ensure Efficient Administration Of Justice, The Seventh Circuit's Decision Allowing Indirect Purchaser Suits Should Be Reviewed And Reversed 19

Conclusion 23

Appendices ..... (bound separately)

TABLE OF AUTHORITIES

CASES:	PAGE
Abbott Dairies v. Butz, 584 F.2d 12 (3d Cir. 1978) .	15
Arizona v. Shamrock Foods Co., 729 F.2d 1208 (9th Cir. 1984), *cert. denied*, 469 U.S. 1197 (1985)	15
In re Beef Industry Antitrust Litigation, 600 F.2d 1148 (5th Cir. 1979), *cert. denied*, 449 U.S. 905 (1980)	16
Eastern Air Lines, Inc. v. Atlantic Richfield Co., 609 F.2d 497 (Temp. Emer. Ct. App. 1979) ...	17, 18
Gulf Oil Corp. v. Dyke, 734 F.2d 797 (Temp. Emer. Ct. App.), *cert. denied*, 469 U.S. 852 (1984) ...	17, 18
Hanover Shoe, Inc. v. United Shoe Machinery Corp., 392 U.S. 481 (1968)	8, 12, 15, 19, 20, 21
Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977)	*passim*
International Ass'n of Machinists v. OPEC, 477 F. Supp. 553 (C.D. Cal. 1979), *aff'd on other grounds*, 649 F.2d 1354 (9th Cir. 1981), *cert. denied*, 454 U.S. 1163 (1982)	15
Jewish Hospital Ass'n v. Stewart Mechanical Enterprises, Inc., 628 F.2d 971 (6th Cir. 1980), *cert. denied*, 450 U.S. 966 (1981)	17, 18
Lefrak v. Arabian American Oil Co., 487 F. Supp. 808 (E.D.N.Y. 1980)	15
Merican, Inc. v. Caterpillar Tractor, Co., 713 F.2d 958 (3d Cir. 1983), *cert denied*, 465 U.S. 1024 (1984)	15

In re Mid-West Milk Monopolization Litigation, 529 F. Supp. 1326 (W.D. Mo. 1982), *aff'd*, 730 F.2d 528 (8th Cir.), *cert. denied*, 469 U.S. 924 (1984) 17

In re Mid-West Milk Monopolization Litigation, 730 F.2d 528 (8th Cir.), *cert. denied*, 469 U.S. 924 (1984) 15, 17

Midwest Paper Products Co. v. Continental Group, Inc., 596 F.2d 573 (3d Cir. 1979) 15, 16, 19

New York v. Hendrickson Bros., Inc., 840 F.2d 1065 (2d Cir. 1988), *petition for cert. filed*, 57 U.S.L.W. 3061 (U.S. July 26, 1988) (No. 88-21) . 16

Phillips v. Crown Center Petroleum Corp., 602 F.2d 616 (4th Cir. 1979), *cert. denied*, 444 U.S. 1074 (1980) 15, 16

Square D Co. v. Niagara Frontier Tariff Bureau, Inc., 476 U.S. 409 (1986) 9

United States v. Consolidated Edison Co., 580 F.2d 1122 (2d Cir. 1978) 15, 16

In re Wyoming Tight Sands Antitrust Litigation, 1988-2 Trade Cas. (CCH) ¶ 68,164 (D. Kan.), *appeal docketed*, Nos. 88-8042, 88-8043 (10th Cir. 1988) 9, 15, 22

Zinser v. Continental Grain Co., 660 F.2d 754 (10th Cir. 1981), *cert. denied*, 455 U.S. 941 (1982) 17

STATUTES:

Section 4 of the Clayton Act, 15 U.S.C. § 15 .. 2, 3, 7, 20
Section 16 of the Clayton Act, 15 U.S.C. § 26 ... 3
28 U.S.C. § 1254(1) 2
28 U.S.C. § 1292(b) 2
Natural Gas Act, 15 U.S.C. §§ 717-717w 4, 6
Natural Gas Policy Act, 15 U.S.C. §§ 3301 *et seq.* . 4

MISCELLANEOUS:

Comment, *A Legal and Economic Analysis of the Cost-Plus Contract Exception in* Hanover Shoe *and* Illinois Brick, 47 U. Chi. L. Rev. 743 (1980) . 13
Landes & Posner, *Should Indirect Purchasers Have Standing to Sue Under the Antitrust Laws? Economic Analysis of the Rule of* Illinois Brick, 46 U. Chi. L. Rev. 602 (1979) ... 21, 22

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

PANHANDLE EASTERN PIPE LINE COMPANY,

Petitioner,

v.

STATE OF ILLINOIS, ex rel. NEIL F. HARTIGAN, Attorney General of the State of Illinois,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioner Panhandle Eastern Pipe Line Company ("Panhandle")[1] respectfully requests that a writ of certiorari issue with respect to the judgment and *en banc* opinion of the United States Court of Appeals for the Seventh Circuit entered in this case on July 18, 1988.

---

[1] Panhandle Eastern Pipe Line Company is a wholly owned subsidiary of Panhandle Eastern Corporation.

OPINIONS BELOW

The *en banc* opinion of the United States Court of Appeals for the Seventh Circuit is reported at 852 F.2d 891 (7th Cir. 1988) and is printed in the appendix at page A-1. The opinion of the three judge panel is reported at 839 F.2d 1206 (7th Cir. 1988) and is printed in the appendix at page B-1. The order of the Honorable Michael M. Mihm denying Panhandle's motion to dismiss is unreported and is printed in the appendix at page C-1.

JURISDICTION

The Seventh Circuit on September 4, 1985 granted petitioner's application for leave to take interlocutory appeal pursuant to 28 U.S.C. § 1292(b). The date of entry of the judgment of the Seventh Circuit was July 18, 1988. This petition was filed within ninety days thereafter and the jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTE INVOLVED

Section 4 of the Clayton Act, 15 U.S.C. § 15, provides in pertinent part:

> . . . [A]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district

court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.

STATEMENT OF THE CASE

Proceedings Below: Respondent, Neil Hartigan, Attorney General for the State of Illinois ("Attorney General"), brought *parens patriae* and class action claims for damages and injunctive relief under federal and state antitrust laws in February, 1984, in the United States District Court for the Central District of Illinois on behalf of indirect purchasers of gas from Panhandle in Illinois. The district court certified a class of over 300,000 indirect purchasers located in areas served exclusively by Panhandle.

The Attorney General alleges that Central Illinois Light Company ("CILCO"), a direct purchaser from Panhandle, was unable in 1983 to purchase certain gas from another supplier because Panhandle allegedly refused to transport this gas for CILCO; that, as a result, CILCO had to purchase higher priced gas from Panhandle; and that CILCO passed this so-called overcharge through to its customers (indirect purchasers). CILCO is the only one of Panhandle's 23 utility customers in Illinois specifically alleged to have made a request for transportation. Jurisdiction of the district court was based on Sections 4 and 16 of the Clayton Act, 15 U.S.C. §§ 15, 26. App. G-1.

Panhandle moved to dismiss all damage claims on behalf of indirect purchasers as barred by *Illinois Brick Co. v.*

Illinois, 431 U.S. 720 (1977). Although the district court acknowledged that the entire alleged overcharge was not passed on to CILCO's customers, it denied this motion, allowed the suit to proceed as to all indirect purchasers in the class and certified its order under 28 U.S.C. § 1292(b). App. C-7 - 8. The Seventh Circuit initially reversed the district court and barred all indirect purchaser damage claims. App. B-1. Dissenting in part, Judge Posner would have allowed the claims of "residential" indirect purchasers. On July 18, 1988, Judge Posner, in an opinion for a six-to-four majority of the court *en banc*, affirmed the district court as to claims of "residential" gas customers, but reversed as to claims of "industrial" customers and ordered their dismissal. App. A-14. The court's opinion expressly sanctions suits both by the direct purchaser and by "residential" indirect purchasers.

The result reached by the Seventh Circuit is novel and was not advocated by either party. The four dissenting judges would have reversed the district court and dismissed the claims of all indirect purchasers.

Panhandle's Operations: Panhandle owns and operates an interstate natural gas pipeline that brings gas from producing areas in the Gulf Coast and Mid-Continent areas of the United States to consuming regions in the Midwest. Panhandle is regulated by the Federal Energy Regulatory Commission ("FERC") under the Natural Gas Act, 15 U.S.C. §§ 717-717w, and the Natural Gas Policy Act, 15 U.S.C. §§ 3301 *et seq.* Panhandle purchases gas from producers, and sells most of this gas to local gas distribution companies ("LDC's"), such as CILCO, under approved tariffs and rate schedules. Increasingly, Panhandle also transports natural gas owned by others, including LDC's.

LDC Operations: CILCO and other LDC's resell most of the natural gas they purchase to end users for space

heating, water heating, cooking, air conditioning, irrigation, grain drying, electric generation, as a fuel for gas turbines, gas compressors, pumps, and other machinery, and as feedstock for the manufacture of synthetic materials and chemicals. LDC customers include both owners and renters of residential, commercial, industrial and agricultural property, such as hospitals and other institutions, factory operators, retailers, wholesalers, and farmers. Many LDC customers, of all types, have the actual or potential ability to use alternate fuels to perform the above functions. The Chairman of the Illinois Commerce Commission testified that even residential customers' demand for gas is elastic.

Customers of LDC's do not have contracts to purchase any fixed quantity of natural gas. Their gas purchases vary depending on a myriad of factors, including temperature, precipitation, the price of gas and alternate fuels, the cost of conservation measures, and the demand for their manufactured and agricultural products.

State Utility Regulation: CILCO and other investor-owned LDC's in Illinois are regulated by the Illinois Commerce Commission ("Ill.C.C."), which must approve their rates and tariffs.[2] LDC gas sales rates have three components: a fixed monthly demand charge; a uniform purchase gas adjustment charge covering the LDC's cost of gas; and a charge per unit of gas purchased covering, among other things, the LDC's allowed profit.

Since mid-1983, LDC's regulated by the Ill.C.C. have been required to comply with the Illinois Uniform Purchase Gas Adjustment ("PGA") with respect to the cost

[2] Of the 23 LDC's PEPL serves in Illinois, 17 are owned by municipal bodies and are not subject to the jurisdiction of the Ill.C.C.

of gas sold to their customers. Under the PGA mechanism, the price of gas to LDC customers is based on a monthly prediction of the weighted average cost of gas to the LDC. At the end of each year, actual and estimated gas costs are reconciled in a proceeding before the Ill.C.C. In 1983 and 1984, CILCO over-collected from its customers and it therefore made a refund after the yearly reconciliation through a reduction in the per unit price of gas purchased in the subsequent year. Customers who first received service after the reconciliation benefitted from this credit and therefore did not pay the full cost of gas during the refund period.

CILCO's Operations: Since the 1950's, CILCO has qualified as a "general service customer" under Panhandle's approved tariff. The tariff obligated Panhandle to provide all the gas CILCO required for its major service areas up to a stated contract demand. The principal condition for service under this tariff was that CILCO would not purchase natural gas for resale in those service areas from any "natural gas company" (as defined in 15 U.S.C. § 717a(6)) other than Panhandle. Under this tariff, Panhandle supplied virtually 100% of CILCO's gas requirements for those service areas. For its other service areas, CILCO purchased gas from other suppliers. Under the PGA, CILCO aggregated the cost of gas from all of its suppliers and applied the same purchased gas charge to all of its customers, irrespective of the source of gas actually supplied to the customer.

CILCO's sales to its customers in the early 1980's decreased (in one year, by as much as 14.7%) when the cost of Panhandle's gas to CILCO increased. From 1982 to 1984, CILCO lost 1754 customers of all types, including residential customers.

In 1983, CILCO responded to an increase in the cost of Panhandle's gas by adopting "Rate 7" for certain customers capable of switching to alternate fuels. Under Rate 7, CILCO was able to maintain essentially the same total price for gas service to Rate 7 customers by reducing its recovery of fixed costs and its profit. The effect of Rate 7 was to reduce CILCO's revenues by nearly $1 million. CILCO withdrew Rate 7 when Panhandle reduced the cost of its gas. Again, in 1986, CILCO absorbed gas costs by adopting Rider AP, which provided a lower rate to certain customers able to use alternate fuels.

CILCO's Suit: On March 16, 1987, CILCO, as the direct purchaser, filed an antitrust action in federal court against Panhandle alleging the same violations and seeking recovery of the same alleged overcharge as does the Attorney General in this action. App. F-11 - 12. CILCO claims damages in excess of $70 million with respect to sales made to residential, industrial and other customers, and also claims lost profits on sales not made.

REASONS FOR GRANTING THE WRIT

I. The Seventh Circuit's Decision Is In Direct Conflict With This Court's Controlling Decisions In *Hanover Shoe* And *Illinois Brick*

The Seventh Circuit's decision conflicts with and frustrates the general indirect purchaser bar by requiring, in each new case filed, an inquiry as to whether the reasons for the general bar exist in that specific case. It reinjects the complex issues and risk of duplicative recovery *Illinois Brick* sought to eliminate and defies this Court's settled construction of Section 4 of the Clayton Act that

the direct purchaser is the party "injured". It also impermissibly expands the narrow cost-plus exception. *Illinois Brick* bars all damage claims by indirect customers unless the "customer is committed to buying a fixed quantity regardless of price." 431 U.S. at 736. The decision here eliminates the fixed quantity requirement. As Senior Judge Fairchild aptly stated in his dissent below, "the Supreme Court did not leave it to the discretion of the lower courts to create new exceptions." App. A-19. The decision below incorrectly assumed such discretion and in effect created a new exception.

A. The Seventh Circuit's Decision Improperly Reexamines And Substantially Erodes The General Bar Of Indirect Purchaser Claims

Review is required because the Seventh Circuit's decision subverts *Illinois Brick*'s rationale and erodes its holding. In *Illinois Brick*, this Court established a general bar to indirect purchaser damage claims for allegedly illegal overcharges. The Court reaffirmed its holding in *Hanover Shoe Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968), that, as a matter of law, the direct purchaser is the only person injured within the meaning of Section 4, and that it is injured by the full amount of the alleged overcharge. This Court found compelling policy reasons for a general bar: to provide the greatest incentive for direct purchasers to sue, to avoid complex damage tracing and apportionment problems, and to avoid the risk of duplicative recovery. *Illinois Brick*, 431 U.S. at 736-48. Even though the Court recognized that direct purchasers may not sue at all and may pass on the entire overcharge, it declined to sanction indirect purchaser suits in such cases. 431 U.S. at 746. The Court also recognized that damage tracing and apportionment problems, or the risk of duplicative recovery, would not be as serious in some

cases as in others, but again it declined to sanction indirect purchaser suits. 431 U.S. at 743-44.

The Seventh Circuit made a case-by-case determination as to whether the reasons this Court gave for its general bar of indirect purchaser suits are present here and found they are not. App. A-5 - 6. Its ruling thus confines *Illinois Brick* to its facts, contrary to this Court's express intent. 431 U.S. at 729. Because the general bar of indirect purchaser suits is based upon this Court's settled construction of Section 4, which Congress has not overruled despite repeated efforts during the past 11 years, the ruling also invades the province of this Court and Congress to reexamine the reasons for the bar. *See Illinois Brick*, 431 U.S. at 736-37; *Square D Co. v. Niagara Frontier Tariff Bureau, Inc.*, 476 U.S. 409, 424 (1986).

The court below not only erred by requiring a case-by-case inquiry as to whether the reasons for the general bar are present, but also erred in concluding that they do not apply in this case.

Direct Purchaser's Incentive to Sue. The Seventh Circuit incorrectly assumes that direct purchasers subject to rate regulation, such as CILCO, lack sufficient incentive to sue. App. A-6 - 7. CILCO *has* sued Panhandle under the antitrust laws for the same alleged overcharge. Moreover, CILCO has vigorously challenged Panhandle in numerous FERC proceedings. It even filed a complaint before the FERC under Section 5 of the Natural Gas Act, 15 U.S.C. § 717d, challenging the same conduct at issue here. Likewise, other regulated gas utilities as direct purchasers have sought antitrust damages from interstate pipelines for allegedly illegal overcharges. *See In re Wyoming Tight Sands Antitrust Litigation*, 1988-2 Trade Cas. (CCH) ¶ 68,164 (D. Kan.), *appeal docketed*, Nos. 88-8042, 88-8043

(10th Cir. 1988). The Seventh Circuit's depiction of CILCO and other regulated gas utilities as "reluctant suitors" is not only contrary to fact,[3] but is also immaterial in light of this Court's refusal to allow indirect purchaser damage suits even where the direct purchaser has not sued. *Illinois Brick*, 431 U.S. at 746.

Damage Tracing and Apportionment Problems. The Seventh Circuit implicitly recognized that damage tracing and apportionment problems do exist here. App. A-13. Rather than dismissing all indirect purchaser claims, however, the court, in an apparent attempt to avoid these problems, made, *sua sponte*, a classification of "residential" and "industrial" customers, even though *Illinois Brick* forbids the classification of indirect purchasers. 431 U.S. at 744-45. This classification lacks a factual as well as a legal basis. The same PGA mechanism (*see supra*, pp. 5-6), which is the basis for the pass-through of gas costs, applies to all of CILCO's customers without distinction between "residential" and "industrial" customers.

Such customers, and those of other direct purchasers, do not fall into simple and discrete "residential" and "industrial" categories. *See supra*, pp. 4-5. CILCO, for example, sells gas for residential space heating under at least two different rate classifications, one of which also includes gas sales for commercial space heating and other

---

[3] While the court's speculations are wholly irrelevant, there are many possible explanations for CILCO's delay in filing suit. CILCO may have delayed filing because the district court held that the indirect purchasers were the proper parties to sue. Moreover, CILCO had a clear economic interest in "free riding" on the Attorney General's efforts in this case. It is equally likely that CILCO considered the federal regulatory forum as the proper one in which to resolve the tariff issues on which the claims here are based.

uses. *See* CILCO's Tariffs, R. 105 at 129, R. 197. Indirect purchasers of all types have the ability either to use alternate fuels or to reduce substantially their purchases of gas in response to higher prices. Some "industrial" customers, however, may not have this ability.

The Seventh Circuit concluded, erroneously, that the damage tracing and apportionment problems which exist here should not bar the claims of residential customers by making unwarranted assumptions concerning the operation of public utility regulation of the direct purchaser. But the PGA mechanism does not guarantee a total pass-through of gas costs, as the Seventh Circuit itself recognized, because the direct purchaser can absorb a portion of an alleged overcharge in gas costs through a rate change or due to a sales decline causing it to under-recover its approved operating costs and profit. App. A-8, A-13 - 14.

Risk of Duplicative Recovery. The risk of multiple recovery clearly is present because CILCO already has sued Panhandle for the same overcharge plaintiff seeks.[4]

B. The Seventh Circuit's Decision Expands The Cost-Plus Exception By Eliminating The Preexisting Fixed Quantity Contract Requirement

Review is also required because the Seventh Circuit has discarded the preexisting fixed quantity contract require-

---

[4] Although CILCO's case presently is pending before the same district judge as this case, CILCO has filed a jury demand. This may necessitate transfer of the case prior to trial because potential jurors are customers of CILCO and members of the class in this case. Thus, the current district judge may not be able to preside over the CILCO trial and thereby prevent duplicative recovery.

ment from the narrow cost-plus exception,[5] described in *Illinois Brick* as follows:

> But this Court in *Hanover Shoe* indicated the *narrow scope* it intended for any exception to its rule barring pass-on defenses by citing, as the only example of a situation where the defense *might* be permitted, a preexisting cost-plus contract. In such a situation, the purchaser is insulated from any decrease in its sales as a result of attempting to pass-on the overcharge, because its customer is committed to buying a fixed quantity regardless of price. The effect of the overcharge is essentially determined in advance, without reference to the interaction of supply and demand that complicates the determination in the general case.

431 U.S. at 735-36 (emphasis supplied). This Court refused to expand the exception or to create a new one, and stated that it would "adhere to the narrow scope of exemption indicated by" the *Hanover Shoe* decision. 431 U.S. at 745.

This Court described a simple and narrow exception capable of application at the outset of litigation on the basis of existing contractual terms. This exception operates to permit only a single suit and to eliminate uncertainty as to who may file it. The fixed quantity requirement insures that the direct purchaser can suffer no loss in sales and the cost-plus element insures that the direct purchaser passes on the entire overcharge. Thus, the

---

[5] The author of the *en banc* decision, in his dissent from the original panel decision, described this Court's discussion of exceptions in *Hanover Shoe* and *Illinois Brick* as *dicta*. App. B-9. Since the present case involves what appears to be the first affirmative appellate application of the "cost-plus" exception on record evidence, the decision here merits review to reaffirm the narrow scope of the exception in a clear holding.

direct purchaser can suffer no injury under Section 4 and it therefore is barred under *Hanover Shoe* from seeking damages. Only then can the indirect purchaser sue.

The express requirements for this narrow exception are not satisfied here. The indirect purchasers do not have preexisting, fixed quantity commitments and, admittedly, the direct purchaser has lost sales. App. A-9.

The Seventh Circuit nevertheless attempts to construct a substitute for the fixed quantity requirement by theorizing that state utility regulation and the resulting "unused monopoly power" of the direct purchaser as to residential customers are an acceptable "stand-in." App. A-8. Its reformulated exception presumes that state regulation has forced the "utility to operate in a region of its demand curve where 100% passing on of any cost increase [is] the optimal strategy for the utility to follow." App. A-12.

This hypothesis is neither alleged nor is it supported by the record. Moreover, to establish this hypothesis requires consideration of the complex issues *Illinois Brick* sought to eliminate. Furthermore, even if true, the court's presumption—that the indirect purchasers' demand is inelastic—could only explain why the direct purchaser *might attempt* to pass on the cost increase entirely. Only perfectly inelastic demand, guaranteed through a fixed quantity provision, could insulate the direct purchaser from any decrease in sales, thus insuring that it will not choose to absorb part of the alleged overcharge. *See, e.g.*, Comment, *A Legal and Economic Analysis of the Cost-Plus Contract Exception in* Hanover Shoe *and* Illinois Brick, 47 U. Chi. L. Rev. 743, 763, 765 (1980) (cited by the Seventh Circuit, App. A-5).

The court admits that perfect inelasticity of demand is not present here, App. A-9 (*compare* A-9 *with* B-13), as

indeed it had to because CILCO did lose sales and did absorb part of the alleged overcharge. The Seventh Circuit's solution, allowing both the direct and indirect purchasers to sue, diminishes the direct purchaser's incentive to sue, and creates a risk of duplicative recovery not possible under the narrow exception described in *Illinois Brick*. Moreover, the court's rationale relies upon precisely the simplifying economic assumptions and unsupported economic inferences about demand elasticity rejected in *Illinois Brick*.[6] 431 U.S. at 741-42. As a result, the Seventh Circuit excepts simple cost-plus pricing (i.e. a pricing mechanism lacking a preexisting relationship and a fixed quantity requirement) from the general indirect purchaser bar, which this Court expressly declined to do in *Illinois Brick*. 431 U.S. at 744.

II. The Seventh Circuit's Opinion Adds To A Conflict Among The Circuits On The Limited Circumstances That Permit Suits By Indirect Purchasers For Recovery Of An Illegal Overcharge

The Seventh Circuit frankly concedes that its decision is in conflict with other circuits. App. A-3 - 5. Conflicts exist as to whether: 1) a fixed quantity provision is a requirement of a "cost-plus" exception; 2) the express requirements of the exception can be satisfied by some functional equivalent; and 3) the arrangement must be preexisting to guarantee in advance a complete pass-through.

---

[6] While explicit references to demand elasticity in Judge Posner's dissent to the panel's opinion were omitted from his opinion for the court *en banc*, the analysis in both opinions employs this concept.

A. The Circuits Are Split Over The Fixed Quantity Requirement

The Seventh Circuit acknowledged that the Third, Eighth and Ninth Circuits have held that the cost-plus exception requires a fixed quantity provision. App. A-3. *See Midwest Paper Products Co. v. Continental Group, Inc.*, 596 F.2d 573, 577 n.9, 580 (3d Cir. 1979); *In re Mid-West Milk Monopolization Litigation*, 730 F.2d 528, 533 (8th Cir.), *cert. denied*, 469 U.S. 924 (1984); *Arizona v. Shamrock*, 729 F.2d 1208, 1212 n.2 (9th Cir. 1984), *cert. denied*, 469 U.S. 1197 (1985).[7] The Second and Fourth Circuits also require a fixed quantity provision for the assertion of a pass-on defense. *United States v. Consolidated Edison Co.*, 580 F.2d 1122, 1132 n.21 (2d Cir. 1978) (considering *Hanover Shoe* in a breach of contract action); *Phillips v. Crown Center Petroleum Corp.*, 602 F.2d 616 (4th Cir. 1979), *cert. denied*, 444 U.S. 1074 (1980). Under these rulings only one claim for damages is allowed—either by the direct or indirect purchaser.[8]

---

[7] The Third Circuit also has recognized the importance of the fixed quantity requirement in rejecting a pass-on defense under *Hanover Shoe* because the direct purchaser was not insulated from a loss of sales. *See* Abbott Dairies v. Butz, 584 F.2d 12 (3d Cir. 1978). *Cf.* Merican, Inc. v. Caterpillar Tractor, Co., 713 F.2d 958 (3d Cir. 1983), *cert. denied*, 465 U.S. 1024 (1984) (Indirect purchaser suit dismissed because direct purchaser may have been injured by the alleged overcharge).

[8] Numerous district court decisions also have required fixed quantity provisions. *See, e.g.*, Lefrak v. Arabian American Oil Co., 487 F. Supp. 808, 819 (E.D.N.Y. 1980); *In re* Wyoming Tight Sands Antitrust Cases, 1988-2 Trade Cas. (CCH) ¶ 68,164 (D. Kan. 1988), *appeal docketed*, Nos. 88-8042, 88-8043 (10th Cir. 1988); International Ass'n of Machinists v. OPEC, 447 F. Supp. 553, 562 (C.D. Cal. 1979), *aff'd on other grounds*, 649 F.2d 1354 (9th Cir. 1981), *cert. denied*, 454 U.S. 1163 (1982).

The only circuits which have not required a fixed quantity provision, in conflict with the above decisions (and *Illinois Brick*), are the Seventh in this case and the Fifth in *In re Beef Industry Antitrust Litigation*, 600 F.2d 1148, 1164 (5th Cir. 1979), *cert. denied*, 449 U.S. 905 (1980).

B. The Circuits Are Divided As To The Propriety Of The Functional Equivalent Approach

The circuits also are divided over whether any of the components of the "preexisting, fixed quantity, cost-plus contract" exception can be satisfied by their "functional equivalent," such as economic conditions and pricing mechanisms which allegedly insure a total pass-through of an alleged overcharge.

The Fifth Circuit has adopted the "functional equivalent" test, the most liberal standard allowing indirect purchasers to sue. *In re Beef, supra.* It held that plaintiffs need not prove a preexisting, cost-plus contract, but can satisfy the exception by proving—based on the inelasticity of the supply market and the use of a rigid, industry-wide pricing formula—that the impact of price changes can be determined in advance.

The Third Circuit, in accordance with *Illinois Brick*, refused to expand the exception to include such simple cost-plus arrangements and thereby rejected the functional equivalent approach. *Midwest Paper*, 596 F.2d at 577 n.9, 580. The Second and Fourth Circuits are in accord with this position, having rejected pass-on defenses where there were no preexisting, fixed quantity, cost-plus contracts. *United States v. Consolidated Edison Co., supra*; *Phillips v. Crown Center Petroleum Corp., supra*; *see also New York v. Hendrickson Bros., Inc.*, 840 F.2d 1065, 1078-80 (2d Cir. 1988), *petition for cert. filed*, 57 U.S.L.W. 3061 (U.S. July 26, 1988) (No. 88-21) (no pass-on defense because no proof of "a contract showing that the effect of their

[defendants'] overcharges was 'essentially determined in advance' ").

The Seventh Circuit eschews the "functional equivalent" test of *In re Beef* because that test employs an analysis this Court "disparaged in *Illinois Brick*" and because the test was "effectively criticized" in *In re Mid-West Milk Monopolization Litigation*, 529 F. Supp. 1326, 1337-38 (W.D. Mo. 1982), *aff'd*, 730 F.2d 528 (8th Cir.), *cert. denied*, 469 U.S. 924 (1984). App. A-5. Thus, the instant decision conflicts with the Fifth Circuit, which adopted the functional equivalent test, as well as with the Third Circuit, which applied *Illinois Brick* literally.[9]

Unless this Court reaffirms the narrow scope of the cost-plus exception announced in *Illinois Brick*, courts applying the functional equivalent test will continue to engage in the complicated factual inquiry it requires.[10]

---

[9] Despite its disclaimer, one could nevertheless conclude that the Seventh Circuit in fact may have used the functional equivalent test because it relied on economic assumptions as a substitute for a pre-existing, fixed quantity, cost-plus contract. App. A-6 - 8, 13-14. Even if true, its decision would still conflict with the Third Circuit. Moreover, the functional equivalent test cannot be satisfied here because regulation of the direct purchaser does not guarantee in advance a complete pass-through of the alleged overcharge and does not insulate the direct purchaser from injury due to lost sales. *See supra*, pp. 10-11.

[10] Other circuits have discussed the "functional equivalent" test, but found the indirect purchaser claims or the pass-on defenses did not satisfy even this test and therefore did not have to accept or reject it. *See* Jewish Hospital Ass'n v. Stewart Mechanical Enterprice, Inc., 628 F.2d 971 (6th Cir. 1980), *cert. denied*, 450 U.S. 966 (1981); In re Mid-West Milk Monopolization Litigation, 730 F.2d 528, 533 (8th Cir.), *cert. denied*, 469 U.S. 924 (1984) (also finding no preexisting, fixed quantity, cost-plus contract); Zinser v. Continental Grain Co., 660 F.2d 754 (10th Cir. 1981), *cert. denied*, 455 U.S. 941 (1982); Eastern Air Lines Inc. v. Atlantic Richfield, 609 F.2d 497 (Temp. Emer. Ct. App. 1979); Gulf Oil Corp. v. Dyke, 734 F.2d 797 (Temp. Emer. Ct. App. 1984), *cert. denied*, 469 U.S. 852 (1985).

C. The Seventh Circuit's Decision Conflicts With A Ruling Of The Sixth Circuit Regarding The "Pre-existence" Requirement

The Seventh Circuit engaged in a *post hoc* examination of rates and sales to determine whether, as to residential customers, the overcharge was passed through. This *post hoc* examination conflicts with *Illinois Brick* and the Sixth Circuit's holding in *Jewish Hospital Ass'n. v. Stewart Mechanical Enterprises, Inc.*, 628 F.2d 971 (6th Cir. 1980), *cert. denied*, 450 U.S. 966 (1981), that there must be a preexisting relationship that insures in advance that the whole overcharge will be passed through. The Sixth Circuit's approach has also been employed by the Temporary Emergency Court of Appeals to bar a pass-on defense even where the trier of fact had determined the amount of the overcharge passed on. *Gulf Oil Corp. v. Dyke*, 734 F.2d 797 (Temp. Emer. Ct. App. 1984), *cert. denied*, 469 U.S. 852 (1985); *see also Eastern Air Lines Inc. v. Atlantic Richfield Co.*, 609 F.2d 497 (Temp. Emer. Ct. App. 1979).

The arrangement here lacks the preexistence factor that guarantees in advance a complete pass-through. Indirect purchasers, including "residentials", not only may vary the quantity of gas they purchase, but also may switch to alternate fuels. Also, direct purchasers can, as did CILCO, lower their profit margins in response to gas price increases and resulting declining sales so as to lower the total price paid by indirect purchasers.

D. The Conflict Is Clear From The *En Banc* Decision Itself

As recognized by the four dissenters, the indirect purchaser claims of both the residential and industrial customers should be barred because the purchases are not pursuant to a fixed quantity contract as is required under

Midwest Paper and *Illinois Brick*. App. A-18. This circumstance creates a conflict, readily conceded by the Seventh Circuit, between its decision and those of other circuits. App. A-3.

III. To Preserve the *Illinois Brick* Rule and To Ensure Efficient Administration of Justice, the Seventh Circuit's Decision Allowing Indirect Purchaser Suits Should Be Reviewed and Reversed

If the instant decision is not reviewed and reversed, the objectives of the *Illinois Brick* and *Hanover Shoe* decisions will be undermined, if not completely frustrated.[11] The Seventh Circuit has authorized antitrust damage claims by both direct and indirect purchasers based on the same alleged overcharge. This diminishes the incentive of direct purchasers to sue, raises complex issues of apportionment and tracing of damages, creates risks of duplicative recovery, and will consume enormous amounts of judicial resources both in this case and in other cases.

The Seventh Circuit's decision barring some, but not all, indirect purchaser claims here creates an unworkable rule which will require the district court to address a number of complex issues that *Illinois Brick* intended to avoid. It lacks a workable standard for distinguishing the industrial, residential, commercial, agricultural, and many

[11] Review of this interlocutory appeal is timely. The district court conducted a trial on liability while this appeal was pending. It has not yet ruled on the merits, but it did reconsider and reaffirm its earlier ruling on *Illinois Brick* based upon the trial record. App. D-2. If liability were found, a trial on damages still would be necessary in which the complex issues discussed in this section will be confronted. Even if liability were not found, those issues may arise in CILCO's action against PEPL. Moreover, absent a subsequent appeal, the instant decision will remain the law, certainly in the Seventh Circuit.

other types of indirect purchasers. It fails to resolve expressly the claims of many customers who are not clearly "industrial" or "residential." *See supra*, pp. 4-5. It fails to establish what degree of demand elasticity entitles various indirect purchasers to sue, and how this must be alleged and proven within the meaning of Section 4. It requires a complicated analysis of purchasing practices and competitive alternatives of various types of indirect purchasers. It lacks general guidelines for application to the circumstances of the many other direct purchasers in this case, as well as in other cases where the direct purchaser is subject to any form of "regulatory cost-plus pricing." This decision reinjects the complex issues, the detailed factual analysis, and the case-by-case determination that *Illinois Brick* and *Hanover Shoe* sought to preclude.

The Seventh Circuit's decision introduces complex apportionment problems within its *ad hoc* "residential" category of indirect purchasers. It allows individual residential indirect purchasers to maintain actions for the amount of the alleged overcharge each paid. The delay in passing on the alleged overcharge resulting from the PGA reconciliation proceeding (*see supra*, p. 6) complicates the determination of the amount of the overcharge borne by an individual residential indirect purchaser. Moreover, the direct purchaser's cost of gas is determined by rolling in the price of gas from all sources, and this cost (which includes the alleged overcharge) is then spread equally among all the direct purchaser's customers, including those who are not members of the class. Thus, the Seventh Circuit's ruling creates apportionment problems because persons not members of the class will have borne part of the overcharge.

The decision here, by permitting both direct and indirect purchaser suits, may also inject similar complex issues in virtually all direct purchaser suits, since defendants in

such suits will be compelled to assert a *Hanover Shoe* defense to avoid the risk of duplicative recovery.

The potential for mischief of the Seventh Circuit's decision is clear—it is certain to interfere with antitrust damage claims by price-regulated plaintiffs, such as taxicab companies, other local and interstate carriers, banks and other financial institutions whose rates are regulated, insurance companies, and of course, local gas, electric, water, and telephone utilities. Moreover, the court's ruling undoubtedly will be raised in pass-through cases involving unregulated direct purchasers. Furthermore, the court's ruling cannot be applied on the basis of the complaint and answer (or even a few simple affidavits), but requires instead extensive evaluation of the cost pass-through characteristics of the plaintiff's pricing practices and of its market. The court below has substituted an enormously complex test for a simple rule in the determination of who is the proper party to sue. As a result, the most efficient enforcer of the antitrust laws—the direct purchaser—will be deterred from suing due to the possibility of reduced damages and the cost of litigating a pass-on defense. *See* Landes & Posner, *Should Indirect Purchasers Have Standing to Sue Under the Antitrust Laws? Economic Analysis of the Rule of* Illinois Brick, 46 U. Chi. L. Rev. 602, 608-9 (1979) ("[T]he direct purchaser is a more efficient enforcer of the antitrust laws than the indirect purchaser and should therefore be given maximum incentive to bring antitrust suits").

In fact, the decision here creates a preferred status for indirect purchaser suits in regulated industries and also may prompt lower courts to employ similar economic assumptions to permit indirect purchaser suits in other market contexts. This will encourage the filing of class actions and *parens patriae* suits, often by Attorneys General. *Cf.* J. Cudahy concurring opinion, App. A-16. This Court opted

to have the antitrust laws enforced by direct purchasers in pass-on situations. Moreover, the Court recognized that class suits often afford little or no benefit to their members. *Illinois Brick*, 431 U.S. at 746-47. It has been noted that Attorneys General may bring class suits for reasons other than their intrinsic antitrust merits. *See* Landes & Posner, *supra*, at 612-13. Here, in the face of widely different federal regulatory policy, the Chairman of the Ill. C.C. used an Attorney's General class suit to further his own regulatory objectives for the interstate natural gas pipeline industry.

The decision undermines the fair and uniform application of the antitrust laws and engenders uncertainty for companies subject to suit in many circuits. Panhandle, for example, transacts business in the Fifth, Sixth, Eighth and Tenth Circuits, as well as the Seventh Circuit. The Tenth Circuit has a pending appeal of a decision dismissing claims brought by Attorneys General on behalf of indirect purchasers of natural gas from a different interstate pipeline. *In re Wyoming Tight Sands Antitrust Litigation, supra.* The risk to Panhandle of disparate treatment therefore is real.

Resolution of the clear conflict between this decision and *Illinois Brick*, as well as the decisions of other circuits, is necessary to promote the objectives of *Illinois Brick* and *Hanover Shoe* and the uniform application of the antitrust laws.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this Court should grant the Petition for Writ of Certiorari to review the *en banc* decision of the United States Court of Appeals for the Seventh Circuit.

Respectfully submitted,

Of Counsel:

JOHN A. SIEGER
IRWIN A. BAIN
PANHANDLE EASTERN
PIPE LINE COMPANY
5400 Westheimer Court
Houston, Texas 77056
(713) 627-5400

PAUL H. LARUE *
JURIS KINS
GREGORY G. WROBEL
JAMES M. MROWICKI
ANDREW M. GARDNER
CHADWELL & KAYSER, LTD.
8500 Sears Tower
Chicago, Illinois 60606
(312) 876-2100

Attorneys for Petitioner
PANHANDLE EASTERN PIPE
LINE COMPANY

* Counsel of Record

DATED: October 17, 1988